

Letter of Findings: 04-20100682
Gross Retail Tax
For the Years 2006, 2007, and 2008

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ISSUES

I. Refrigeration Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(a); IC § 6-2.5-4-1(b)(c); IC § 6-8.1-5-1(c); Rhoades v. Ind. Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Mynsberge v. Dep't of State Revenue, 716 N.E.2d 629 (Ind. Tax Ct. 1999); Tri-States Double Cola Bottling Co. v. Dep't of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); USAir, Inc. v. Ind. Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dept. of State Rev. v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); [45 IAC 2.2-5-8\(b\)](#); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-8\(g\)](#).

Taxpayer argues that its purchase of refrigeration equipment was exempt from sales/use tax because the equipment is directly used in the direct production of its food products.

II. Evaporation Equipment – Gross Retail Tax.

Authority: Dep't of Revenue v. Kimball Int'l, Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(j\)](#); Letter of Findings 04-20050063 (May 22, 2006); Letter of Findings 04-20020168 (May 29, 2003).

Taxpayer maintains that its purchase of evaporation equipment was exempt from sales/use tax because the evaporation equipment is directly used in the direct production of its food products.

III. Packaging Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-2-1(a); IC § 6-2.5-3-2; IC § 6-2.5-5-3(b); IC § 6-2.5-5-5.1(b); [45 IAC 2.2-5-8\(a\)](#); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-8\(k\)](#); [45 IAC 2.2-5-11\(c\)](#); Audit-Gram 4-060 (March 26, 2001).

Taxpayer states that its purchase of equipment used to package its food products was exempt from sales/use tax because the equipment was used in the direct production of its food products.

IV. Hoist – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c); [45 IAC 2.2-5-8\(d\)](#); [45 IAC 2.2-5-8\(f\)](#).

Taxpayer argues that its purchase of a hoist was exempt because the hoist is used in the first step in Taxpayer's production of its food products.

V. Tattooing Ink/Shipping Documents – Gross Retail Tax.

Authority: IC § 6-8.1-5-1(c); [45 IAC 2.2-5-14\(d\)](#); [45 IAC 2.2-5-15](#); Miles, Inc. v. Dept. of State Revenue, 659 N.E.2d 1158 (Ind. Tax Ct. 1995).

Taxpayer maintains that its purchase of tattooing ink is exempt from sales/use tax because the tattooing ink is incorporated into Taxpayer's food products.

VI. Plastic Electronic Enclosure – Gross Retail Tax.

Authority: [45 IAC 2.2-5-8\(h\)\(1\)](#); [45 IAC 2.2-5-8\(h\)\(2\)](#).

Taxpayer states that its purchase of plastic enclosures is exempt from sales/use tax because the plastic enclosures protect electronic components and that the enclosures are directly used in the direct production of Taxpayer's food products.

VII. Tax Rate – Gross Retail Tax.

Authority: IC § 6-2.5-2-1(b).

Taxpayer argues that it is not responsible for an error in which one of Taxpayer's suppliers charged six percent sales tax instead of seven percent.

VIII. Transport Equipment – Gross Retail Tax.

Authority: [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(f\)](#); [45 IAC 2.2-5-8\(f\)\(3\)](#); [45 IAC 2.2-5-8\(h\)\(2\)](#); Webster's II New Riverside University Dictionary (1998).

Taxpayer maintains that it is not responsible for paying sales tax or self-assessing use tax on the purchase of a bucket elevator because the bucket elevator is used in the "rendering" of waste food products.

STATEMENT OF FACTS

Taxpayer processes and markets chicken, beef, and pork products to customers inside Indiana and outside Indiana. Taxpayer purchases animals from a variety of sources. Once the animals are delivered to Taxpayer's facility, the animals are weighed, slaughtered, and processed into one of Taxpayer's food products.

The Department of Revenue (Department) reviewed Taxpayer's business records to determine if Taxpayer paid the appropriate amount of sales tax and use tax. During the audit review, Taxpayer and the Department agreed on a "use statistical sampling methodology." An adjustment was made to account for use tax accrued but not paid to the state. The audit review resulted in the assessment of additional sales/use tax. Taxpayer disagreed

with a portion of that assessment. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for its protest. This Letter of Findings results.

I. Refrigeration Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer purchased two "Work in Process" refrigerators and a "Final Freezer." Taxpayer argues that this cooling equipment is exempt from sales/use tax because the cooling equipment "has an immediate and direct effect upon [Taxpayer's] product..." Taxpayer explains that its food products are not complete until the food products are completely frozen and that it was entitled to purchase the refrigerators and the final freezer without paying sales tax or self-assessing use tax.

The audit report described the equipment as follows:

[Taxpayer's] refrigeration system consists of [two] work in process coolers and a final freezer. Plant engineers determined that final freezer makes of 10 to 15[percent] of the total refrigeration load depending on the season and product. Therefore, the auditors and [T]axpayer personnel agreed to a taxable percentage of 13[percent].

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. *Id.*; *USAir, Inc. v. Ind. Dep't of State Revenue*, 623 N.E.2d 466, 468–69 (Ind. Tax. Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. *Id.* A taxable retail transaction occurs when; (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

However, Taxpayer believes the items are exempt from both sales and use tax pursuant to [45 IAC 2.2-5-8\(b\)](#) which states as follows:

The state gross retail tax does not apply to sales of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property. (Emphasis added).

In particular Taxpayer cites to [45 IAC 2.2-5-8\(d\)](#) as authority for its position that the refrigeration equipment – both the work-in-process coolers and the final freezer – are entirely exempt. The cited regulation states as follows:

Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dept. of State Rev. v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

[45 IAC 2.2-5-8\(b\)](#) like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mysner v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999).

In effect, Taxpayer argues that frozen food constitutes the Taxpayer's product and that this product is not complete until the food leaves its facility. The audit took the position that the "final freezer" acted directly upon Taxpayer's food product and that final freezer was exempt. No doubt it is necessary to preserve the food product in its frozen state until the product leaves Taxpayer's door. However, it should be noted that the regulation also explains in part as follows:

The fact that particular property may be considered essential to the conduct of manufacturing because its use is required either by law or by practical necessity does not mean itself the property "has an immediate effect upon the article being produced." Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property. [45](#)

[IAC 2.2-5-8\(g\)](#). (Emphasis added).

The Department is in agreement with the audit report's analysis concluding that the "final freezer" is exempt because it has a direct effect on Taxpayer's food product. The remaining equipment may be "essential" but – except the to the extent that the audit agreed the "final freezer" was exempt – Taxpayer's refrigeration equipment is not part of the "integrated process which produces tangible personal property." Id.

FINDING

Taxpayer's protest is respectfully denied.

II. Evaporation Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer purchased evaporation equipment which Taxpayer describes as "used to evaporate moisture from the air and [food] product." Taxpayer believes the equipment is exempt because it is "used directly in [its] manufacturing process by removing moisture from the [food] product to reduce the incidence of harmful pathogens on the product."

Taxpayer cites to [45 IAC 2.2-5-8\(c\)](#) as authority for its position that the evaporation equipment is exempt. The regulation states as follows:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

Taxpayer believes the regulation is applicable because "the evaporators are acting directly upon the product to preserve it during the production process...."

The audit report stated that the evaporators are "used as part of the cooling system at [Taxpayer's] plant [and] are used in all air conditioning systems to remove moisture." The audit noted that the evaporators do help to keep moisture out of the plant but disagreed as to the applicability of the exemption stating that "there was no positive causal effect on tangible personal property." The audit found the evaporation equipment was subject to tax pursuant to [45 IAC 2.2-5-8\(j\)](#) which states as follows:

Managerial, sales, and other non-operational activities. Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax. This category includes, but is not limited to, tangible personal property used in any of the following activities: management and administration; selling and marketing; exhibition of manufactured or processed products; safety or fire prevention equipment which does not have an immediate effect on the product; space heating; ventilation and cooling for general temperature control; illumination; heating equipment for general temperature control; and shipping and loading. (Emphasis added).

Indiana case law on this issue is instructive. In *Ind. Dep't of Revenue v. Kimball Int'l, Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988), the taxpayer claimed it qualified for the manufacturing exemption for its paint spray booths, air "make up" units (including component parts) located in the taxpayer's finishing rooms (collectively "paint booths"), which were used to finish wood products such as pianos and furniture. The court recited the relevant law, stating that a taxpayer's equipment "will be held exempt if it is an essential and integral part of an integrated process that produces tangible personal property." Id. at 457. The paint booths came "into play during the final phase of the manufacturing process, when the finish is applied" and were "isolated from the rest of each plant." Id. at 455. The spray booths created an airflow that promoted drying of newly applied finishes. This process guarded against paint blistering and controlled paint flaws in newly applied finish. By recycling air at a rate of 120,000 ft³ per minute, the paint booths also removed excess harmful chemicals that were byproducts of the process. Moreover, without the temperature and humidity controls, the finish would become cloudy and the product unmarketable. The paint booths were therefore found to be integral and essential to the manufacturing process. The court granted Kimball the manufacturing exemption for the natural gas used in the paint booths. Id. at 457.

Manufacturing exemption cases are often decided under the totality of the circumstances, making each case unique. Nonetheless, Kimball and the Department's Letters of Findings which have addressed this particular issue provide two elements for obtaining a sales tax refund under the manufacturing exemption. First, the ventilation or air conditioning must play an active and integral role in the manufacturing process. In other words, but for the use of the Taxpayer's evaporators, the manufacturing process would be impossible and a final marketable product would not be produced. See Letter of Findings 04-20050063 (May 22, 2006); Letter of Findings 04-20020168 (May 29, 2003). While using the evaporators can be an element of the manufacturing process, merely managing or conditioning the air environment of an entire plant, by itself, is not manufacturing. Second, only clearly demarcated areas in which there is active manufacturing that depends on a controlled environment are entitled to the exemption. For example, paint booths or finishing stalls within a plant are such areas. The mere fact that the food processing occurs within an open area of a plant does not mean the evaporators are exempt, unless the size and volume of the manufactured product is so large as to dwarf the plant and render the whole interior an integral part of the processing facility. In Taxpayer's facility, the evaporators operate to "condition" the environment within that facility rather a specific, demarcated area within that facility.

FINDING

Taxpayer's protest is respectfully denied.

III. Packaging Equipment – Gross Retail Tax.**DISCUSSION**

Taxpayer maintains it was not required to pay sales or self-assess use tax on the purchase of "packaging equipment." Specifically, taxpayer points to "strapping equipment which is used to attach metal bands around the box of product to further contain the product." Taxpayer also points to "tray forming equipment which is used to mold plastic trays that are a part of the packaging of cut pork products." Taxpayer "believes that the strapping and tray forming equipment are all essential and integrated in the production process of manufacturing a saleable product and this equipment is used to package the product."

The audit report found that the items were not exempt pursuant to [45 IAC 2.2-5-8\(d\)](#) which states as follows: "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

IC § 6-2.5-2-1(a) provides, "An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana. (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state."

IC § 6-2.5-3-2 provides that, "An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction."

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). An exemption from use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional, particularized exemptions from sales tax and use tax.

The Department's audit determined that the strapping equipment and the tray forming equipment were taxable because neither was directly used in the direct manufacturing process of Taxpayer's food products.

IC § 6-2.5-5-3(b), in pertinent part, states, "[T]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property."

IC § 6-2.5-5-1(b) provides, in part, "Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture."

The cited exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. Machinery, tools, and equipment are directly used in the production process if they have an immediate effect on the article being produced. [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. Id. An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." Id.

[45 IAC 2.2-5-8\(k\)](#) describes "direct production" as the performance of an integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired, and that the change must be substantial resulting in a transformation of the property into a different and distinct product. The exemption for direct use in production is further explained at [45 IAC 2.2-5-11\(c\)](#).

The state gross retail tax shall not apply to purchases of tangible personal property to be directly used by the purchaser in the production or manufacturing process of any manufacturing or agricultural machinery, tools, or equipment, provided that the machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect upon the article being produced or manufactured. The property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property. (Emphasis added).

Finally, [45 IAC 2.2-5-8\(d\)](#) states, "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Taxpayer produces food products within an integrated production process which produces tangible personal property in the form of food products. Taxpayer is in the business of producing those food products, and its customers are interested in obtaining those food products. Therefore, the object of a Taxpayer/customer transaction is the sale of the food products. The strapping equipment and the tray forming equipment facilitate the intermediate transfer of the food products but is not the object of the transaction. The strapping equipment and

the tray forming equipment are tangential to the production of the food products. The strapping equipment and tray forming equipment do not have "an immediate effect on the article being produced...." As the Department has explained in the past, "Purchases of machinery, tools, equipment, and supplies used or consumed in producing or applying wrapping materials to a packaged completed product are subject to Sales Tax" Audit-Gram 4-060 (March 26, 2001) 24 Ind. Reg. 2604.

FINDING

Taxpayer's protest is respectfully denied.

IV. Hoist – Gross Retail Tax.

DISCUSSION

Taxpayer purchased a hoist which it believes is not subject to sales tax nor is it subject to the state's use tax. Taxpayer explained that the "hoist is used to move hogs that have been stunned through the initial slaughtering process. Since the stunning of the hog is the first step of the integrated process of processing these hogs, [the] hoist is directly used in the integrated process...."

Taxpayer cites to [45 IAC 2.2-5-8\(d\)](#) as authority for its claims that the hoist is exempt. The regulation states as follows:

"Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

Based on the information provided, the Department is prepared to agree that Taxpayer has met its burden under IC § 6-8.1-5-1(c), of establishing that the hoist is exempt pursuant to [45 IAC 2.2-5-8\(f\)](#) which exempts, "Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process."

FINDING

Taxpayer's protest is sustained.

V. Tattooing Ink/Shipping Documents – Gross Retail Tax.

DISCUSSION

Taxpayer purchased tattooing ink which it explains is "used on hogs to mark them...." "The ink is applied to the ear of the hog and is a part of the hog all the way through the production process." Taxpayer also purchases "specific shipping documentation paper that is a part of every product from [Taxpayer's] location." Taxpayer further explains that, "The tattooing ink is used to mark the hogs at the beginning of the production process." Taxpayer states that "this ink remains and is a part of the final product and should qualify for the exemption." Taxpayer believes the ink is exempt pursuant to [45 IAC 2.2-5-14\(d\)](#) as follows:

(d) The purchase of tangible personal property which is to be incorporated by the purchaser as a material or an integral part is exempt from tax. "Incorporated as a material or an integral part into tangible personal property for sale by such purchaser" means:

- (1) That the material must be physically incorporated into and become a component of the finished product;
- (2) The material must constitute a material or an integral part of the finished product; and
- (3) The tangible personal property must be produced for sale by the purchaser.

Although a reasonable argument can be made that the ink is "physically incorporated" into the food products sold to its customer, the Department is unable to agree that the ink becomes a "material" part of those products. Based on Taxpayer's description, it appears that the ink is used by Taxpayer to track the hog during the production process and is neither essential nor integral to the food product which its customers purchase.

Taxpayer bought paper "preprinted with information regarding the product being sold." Taxpayer states that these papers "are resold to all customers as a part of the product that they purchase and is in the 'same form' as when it was purchased."

Taxpayer believes that the shipping documents are exempt based on [45 IAC 2.2-5-15](#) which states as follows:

- (a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.
- (b) General rule. Sales of tangible personal property for resale, rental or leasing are exempt from tax if all of the following conditions are satisfied:

- (1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;
- (2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and
- (3) The property is resold, rented or leased in the same form in which it was purchased.

(c) Application of general rule.

- (1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to

consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property.

(2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.

(3) The property must be resold, rented or leased in the same form in which it was purchased.

The Department is unable to agree that Taxpayer has met its burden under IC § 6-8.1-5-1(c) of establishing that the shipping labels are an integral part of the product being sold to its customers. Taxpayer's argument that the shipping labels are sold to its customers is unavailing because Taxpayer did not charge its customers a separately, itemized cost for the labels neither is there any evidence that the customers bargained for the "purchase" of the labels. See *Miles, Inc. v. Dept. of State Revenue*, 659 N.E.2d 1158, 1165 (Ind. Tax Ct. 1995).

FINDING

Taxpayer's protest is respectfully denied.

VI. Plastic Electronic Enclosure – Gross Retail Tax.

DISCUSSION

Taxpayer purchased a "plastic enclosure" which it believes is not subject to sales or use tax. The plastic encloses the "electronics that controlled the weighing of product in the production process... [and] is physically attached to the production equipment." Taxpayer believes the plastic enclosure is exempt because "it is a part of the production equipment."

As authority for its position, Taxpayer cites to [45 IAC 2.2-5-8\(h\)\(2\)](#) which states:

Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax. (Emphasis added).

The Department's audit found that the plastic enclosures were not exempt based on [45 IAC 2.2-5-8\(h\)\(1\)](#).

Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

The Department is unable to agree that the plastic enclosures are analogous to replacement parts installed on the electronic scales but are more closely similar to routine maintenance items not exempt from the tax.

FINDING

Taxpayer's protest is respectfully denied.

VII. Tax Rate – Gross Retail Tax.

DISCUSSION

One of Taxpayer's vendors charged Taxpayer six percent sales tax when it should have charged seven percent. The Department's audit found that Taxpayer was responsible for paying the one percent difference. Taxpayer objects on the ground that it is not responsible for the vendor's error.

As authority for its argument, Taxpayer cites to IC § 6-2.5-2-1(b) which states:

The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Taxpayer points out the vendor acts as "an agent for the state" in retail transactions but fails to point out that Taxpayer is the entity which acquired the property and is "liable for the tax on the transaction...."

Taxpayer's reasoning is counter-intuitive; Taxpayer acquired property in a retail transaction and is responsible for paying the sales tax amount. The issue is not whether the vendor or the Taxpayer should be assigned "blame" for this error, but whether Taxpayer should be required to pay the seven percent sales tax.

FINDING

Taxpayer's protest is respectfully denied.

VIII. Transport Equipment – Gross Retail Tax.

DISCUSSION

Taxpayer repaired – or purchased repair parts – for a "bucket elevator" but argues that because the bucket elevator is used in an exempt fashion, the repair – or repair parts – is exempt.

Taxpayer explains as follows:

The bucket elevator is used to transport inedible rendering material from the evisceration/slaughter area to the rendering area. In the rendering area, these materials are then rendered down to make various other marketable products.

Taxpayer concludes that the "elevator is transporting the rendering product from the integrated slaughter process to the integrated rendering process and qualifies for the tax exemption as production equipment."

As authority for its position, Taxpayer cites to [45 IAC 2.2-5-8\(f\)\(3\)](#) which states:

Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

[45 IAC 2.2-5-8\(h\)\(2\)](#) addresses the taxability of replacement parts installed on exempt equipment:

Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt

machinery and equipment, are exempt from tax.

Taxpayer's argument is somewhat ambiguous but the Department will assume that the two invoices referenced replacements parts which were used to repair the bucket elevator. Of course, in order for the parts to be considered "exempt," the bucket elevator itself must be exempt based on [45 IAC 2.2-5-8\(f\)\(3\)](#).

Taxpayer produces food products. The production of the food product results in waste materials. The waste materials are moved to another portion of the Taxpayer's facility where the waste materials are "rendered." ("To reduce, convert, or melt down fat by heating." Webster's II New Riverside University Dictionary 995 (1998). According to Taxpayer, it then sells the rendered product. The Department agrees that Taxpayer operates a production process which results in food products. The Department also agrees that Taxpayer operates a "rendering" process which reduces otherwise "waste" meat products into a product which it then sells. However, the Department must necessarily questions whether the two production processes constitute an "essential and integral part of an integrated process that produces the product...." [45 IAC 2.2-5-8\(c\)](#). The "integrated process" is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)](#).

In this case, there is little indication that the process which results in the food products and the process which results in "rendered" fat are "functionally interrelated but that the "bucket elevator" is best considered under [45 IAC 2.2-5-8\(f\)](#) which states that:

Transportation equipment used to transport work-in-process, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process.

The food product and the rendering facilities are apparently under the same roof but the two activities do not constitute a single "integrated production process."

FINDING

Taxpayer's protest is respectfully denied.

SUMMARY

Taxpayer's purchase of the hoist, used to move hogs that have been stunned through the initial slaughtering process, is exempt; in all other respects, Taxpayer's protest is denied.

Posted: 09/28/2011 by Legislative Services Agency

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